July 2, 1999

The Honorable Bruce Morrison, Chairman
Mr. William P. Apgar
Mr. J. Timothy O'Neill
Federal Housing Finance Board
1777 F Street N.W.
Washington D.C. 20006-5210

Dear Sirs:

We are pleased to forward to you our proposal for a residential asset purchase program. As you know, we initially presented our Mortgage Purchase Proposal (MPP) concept to you in March based on extensive customer research and dialogue. We have had numerous productive discussions with you and your staff in the intervening months. During these discussions, you raised a number of issues requiring more research and explanation. Our expanded proposal addresses these issues and provides additional detail.

Our goals in offering such a program are to make mortgage finance less expensive to obtain for home buyers of modest incomes and in under-served areas; to build on the cooperative nature of the Banks, sharing substantial risk with customers and offering greater flexibility in underwriting than may otherwise be available through secondary market alternatives; to promote healthy competition in the secondary market that will benefit communities; to make operations easy and efficient for customers; and to provide a profitable and prudent mission-related investment for our Banks that is sufficiently attractive to generate the volumes necessary for balance sheet management in an FMMA environment.

We believe that our program can achieve these goals. We have addressed all issues raised by the Finance Board in prior discussions and respectfully ask the Finance Board's approval of this program. As previously discussed, we believe that it would be very beneficial for us to meet with you and your staff as soon as possible in July to go over the proposal and to determine what next steps, if any, are required to put us on a clear track for a Finance Board decision. Our boards have adopted the program and made its implementation one of our top priorities, one that is particularly urgent given the rapid development and implementation of the FMMA regulation.

We appreciate the leadership you have demonstrated in encouraging pilot programs such as MPP, and look forward to meeting with you at your earliest convenience.

Sincerely,

Norman B. Rice
President and CEO

Martin L. Heger
President and CEO

Charles L. Thiemann
President and CEO

MORTGAGE PURCHASE PROPOSAL ISSUES

The Federal Home Loan Banks of Cincinnati, Indianapolis, and Seattle request approval of an asset purchase program, the Mortgage Partnership Program or MPP, by which each FHLBank will purchase mortgages from its members. Mortgages will be purchased after origination, and a risk-sharing account will be used to transfer a substantial portion of the credit risk to the originating member. This program will be operated separately by each FHLBank, although major outsourcing costs to set up and operate such a program, i.e., legal, programming, and ongoing servicing costs, will be shared.

Reasons for such a program

In response to the challenge put forth by Federal Housing Finance Board Chairman Bruce Morrison to focus the investments of the FHLBank System more closely on its core mission, and in our constant effort to provide greater value to our customers, we three FHLBanks have developed this program to meet the following goals.

- Make mortgage loans less expensive and easier to obtain for homebuyers of modest income and for communities that are underserved by the existing mortgage finance system.
- Build on the cooperative ownership structure of each of the FHLBanks; our customers want a product to provide greater control of the secondary market outlet and are willing to accept substantial credit risk to do so.
- Create new competition in the secondary market through a unique approach that
    - provides more profitable lending opportunities that encourage lenders to offer nonconforming products,
    - blends easily into the existing operational policies of retail lenders, and
    - receives clear and favorable capital treatment.
- Develop new mission-related, prudent, and profitable investment opportunities for the FHLBanks to maintain the financial strength of the System and provide appropriate returns to our shareholders.

From the member's perspective

To maximize the health of the national mortgage markets and broaden home ownership opportunities, members need products that will allow them to compete effectively in the home lending market. The products must be easy to administer, receive beneficial capital treatment, and offer a better inclusive price to the member.

Better price: MPP will offer a sale opportunity structured to provide better returns to members than the current secondary market alternatives. Better pricing will allow the originators to be more competitive in their markets while the structure will provide a powerful incentive for them to maintain good credit quality.

Capital: Capital treatment is an essential concern for sellers in any mortgage purchase enterprise. The MPP methods are simple and direct. The member sells the mortgage under low-level recourse treatment, and has to hold capital only in the amount of the lender risk account (to be discussed later in this paper). The absence of any accounting or regulatory ambiguities in the transaction makes it easily accepted by members.

Administration: Another major attraction for members is the simplicity of the operational structure. Given the very thin margins and high level of competition in mortgage originations, members are reluctant to enter relationships with buyers that require any added costs to their mortgage production process. MPP will rely on purchasing processes that are nearly identical to those used by the secondary agencies and other major purchasers, which will allow sellers to depend on their existing infrastructure to a great extent and minimize extra costs.

From the FHLBank perspective

The FHLBanks need to develop an ability to purchase member mortgage assets through a program that provides a return comparable to investments, produces a meaningful volume, and allows for appropriate management of risk.

The proposed Financial Management and Mission Achievement Regulation will require a substantial reduction in the level of traditional investments. Ideally, the reduction will be accomplished without limiting our support for the AHP, lowering the level of dividends (or increasing the effective cost of advances to levels that are unacceptable to our members), or harming our ability to provide other services to members and their communities that must be subsidized by the Banks' core profitability. Also, we must maintain the financial strength necessary to issue permanent capital stock as envisioned in proposed legislation. Therefore, an asset class must be available that is meaningful in terms of both volume and profitability.

Purchasing mortgages from members would provide such an asset class, one that would fulfill the intent of the Federal Housing Finance Board. The draft version of the new Financial Management and Mission Achievement Regulations states:

> Member mortgage assets which result from such transactions must be mortgages or interests in pools of mortgages as to which the member or non-member borrower involved in the transaction retains or guarantees a *substantial* portion of the risk of the transaction. . . [emphasis added].

In addition, we believe that the purchase of mortgages is a legal and appropriate activity for the FHLBank System. When the FHFB approved MPF, its authority to do so was challenged by a group of lenders. The FHFB's subsequent court victory makes clear that it has such authority. A legal opinion on this point is appended as Exhibit A, stating that the Board actually has the authority to approve such a program under any of three bases in law.

Overview of Mortgage Partnership Program

Origination: Under the proposed pilot, each participating member will underwrite, close, fund, and deliver loans to its Federal Home Loan Bank in the same fashion as secondary agency deliveries are made. In underwriting, each lender can use full delegated underwriting subject to the FHLBank's loan program criteria, which will be similar to those criteria used by the agencies. We will exercise underwriting flexibility under the current conforming dollar ceiling to accommodate good loans from all types of retail customers.

Loans that are accepted by an approved loan underwriting or scoring system will be waived for buyback liability. We anticipate that Loan Prospector, Desktop Underwriter, and systems from major market players such as AssetWise, pmiAURA, or others meeting stringent criteria will be approved as acceptable.

To the greatest extent possible, paperwork and processing for members will be the same as that required by the secondary agencies, to eliminate the need to establish a separate back office procedure. Lenders will arrange for primary mortgage insurance from their preferred providers based on the requirements that are standard in the mortgage industry. Lenders will be able to reinsure with a captive reinsurance company if they wish to do so.

Loan quality: The FHLBank will negotiate a master commitment with each participating lender specifying the criteria for the loan program and a mix of business parameters. This might, for example, specify loans not be below a certain credit score, with limited percentages of loans that are cash-out refinance, investor, multi-unit, or above a specified LTV.

Once loans are delivered to the FHLBank, each will be immediately screened for data completeness and compliance with the loan program criteria and mix of business parameters. Other procedures may be developed, such as licensing a specific loan scoring program at the FHLBank to make comparisons among loans or outsourcing further underwriting for loans with certain characteristics that make them a greater risk for lender buyback. In all cases, loans will be audited shortly after delivery for underwriting compliance and lender buyback would be used as needed.

Other factors: Upon successful screening, the FHLBank may pay the lender a modestly better price for the loans than the secondary agencies currently pay to provide an up-front incentive for participation; however, longer term performance will be a major incentive for participation.

Both loan servicing and documentation storage may be retained by members or passed on to firms of their choice, as long as the entity doing the work can demonstrate it meets standards set by the FHLBank.

Credit enhancement

Credit risk management for MPP has been designed to create barriers between credit events and the eventual cost of these events. In general, strong barriers exact two primary costs. First, stricter underwriting standards, such as requiring higher loan scores or lower LTVs, clearly tend to reduce expected losses but also diminish the value of MPP to customers because fewer loans will be eligible for purchase. Second, barriers are ultimately reflected in the price and availability of mortgages for retail customers. The costs of these barriers to protect MPP from credit events make it less competitive. Therefore, the goal in structuring the program has been to define a set of underwriting standards and a program structure that properly balance credit risk to an FHLBank against the need for open and flexible standards to maximize mortgage availability. The FHLBanks'

Boards of Directors will ultimately determine the proper trade-offs and help adjust this balance over time.

Borrower underwriting: Assessing the willingness and cap~city of an individual to pay his or her debts is the cornerstone of any credit risk management process. All the normal underwriting requirements will be in place, with due consideration given to the size of the downpayment, the borrower's income, stability of employment, credit history, and other factors which historically provide credit protection to the investor.

Beyond the basic underwriting criteria, four components will be used to enhance the credit of mortgages purchased by the FHLBank.

PMI: All loans over 80% loan-to-value will be insured with primary mortgage insurance at the time of origination. The amount of coverage required will vary with the loan-to-value percentage as follows.

LTV	Coverage
>80 to 85%	12% or 17%
>85 to 90%	17% or 25%
>90 to 95%	25% or 30%

This type of coverage is the current standard in the industry and is independent of the credit enhancements outlined below. However, it is important to note that the combination of borrower equity plus primary mortgage insurance provides a basic level of protection equal to 20% or more of the original loan balance.

Lender risk account: The lender risk account involves the payment of an incentive to lenders to provide loans of high credit quality so that the lender does indeed bear the primary share of the credit risk. At the time the loan is accepted, the FHLBank will deposit 60 basis points of the face amount into a special account that it will hold for up to ten years. During that period, all losses not covered by primary mortgage insurance will be charged to the risk account to the extent that funds remain available. We are currently exploring ways to scale the potential lender payments in a way that increases the symmetry between the potential payments and the time the pool of loans is outstanding. Any modifications will maintain the overall credit quality of the program.

Starting at the end of year 2, a portion of the funds in the account above a certain required balance will be paid to the lender as shown below.

End of Year	Required Acct. Bal.	Potential Lender Payment
1	60 bps	0 bps
2	55	5
3	50	5
4	40	10
5	30	10
6	20	10
7	15	5
8	10	5
9	5	5
10	0	5

The amounts are calculated as a fraction of the original aggregate mortgage balances from that lender.

The payout schedule to the lender takes into consideration the expected prepayment rate on the loans, the normal distribution of losses on the portfolio, and the lender's desire for payment as early as possible. A ten-year payout period affords loss protection for over 80% of anticipated defaults and represents a reasonable earnings period for lenders. This lender risk account is the key to placing both the burden and the reward of bearing credit risk on the member. Their income is reduced, or increased, as a direct result of the credit quality of their originations.

Supplemental MI: The third component of credit support is a layer of supplementary primary insurance for coverage beyond the normal primary insurance and the lender risk account. The amount of coverage purchased will be set so that the equity plus the normal insurance plus the supplemental insurance total 40% of the original value, thus reducing the exposure on individual loans to 60% of the original value.

To handle this insurance efficiently, the FHLBank will buy the insurance from one carrier on behalf of all lenders by paying an annual premium. This will ensure consistent execution and reduce administrative costs.

Cleanup fund: The fourth component of the credit support is a cleanup reserve fund that would be established to cover losses that exceed normal primary insurance, the lender risk account, and the supplemental mortgage insurance. In all but extreme loss scenarios, this reserve fund would not have any losses charged to it until after year 10. The fund would be established and held by the FHLBank with a 5 to 6 basis point annual contribution on the outstanding portfolio so that the fund grows to and is maintained at 50 basis points of the outstanding portfolio.

The cleanup reserve fund represents an efficient use of FHLBank capital in creating a AA asset while placing the related credit risk for the FHLBank at the extreme end of the loss spectrum.

Risk management

These four components, the primary mortgage insurance, the lender risk account, the supplementary insurance, and the clean-up fund, provide substantial protection for the FHLBank in this program.

The 60 basis point lender risk account, which is in effect provided by the member who receives all moneys not used to replace losses, is sufficient to cover all expected losses beyond equity and primary mortgage insurance, even under adverse scenarios. Several examples support the depth of protection afforded to an FHLBank through this account. For instance, Fannie Mae's loss experience, based on its financial statements, has averaged 4.5 basis points of its average outstanding loan balances over the past five years. The annual average has ranged from 5.6 basis points in 1994 to 2.7 basis points in 1998. This translates to a lifetime loss of 15 to 20 basis points of the original mortgage balances. Thus, a 60 basis point lender risk account provides credit loss protection three to four times the normal expected losses.

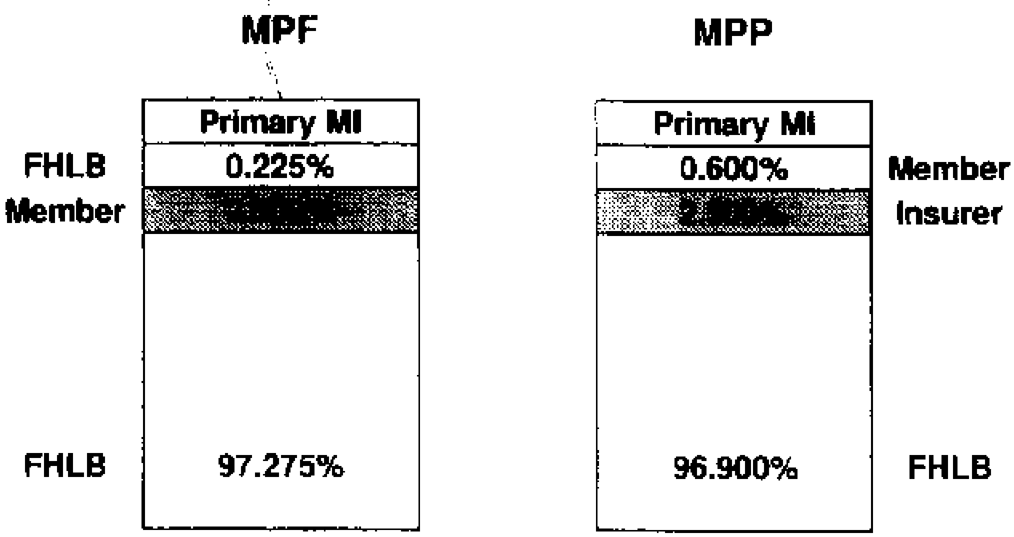
If we predicate a loan-to-value mix representative of recent Fannie and Freddie purchases, a 60 basis point reserve will be sufficient to cover a loss incidence of 6% (meaning 6 out of each 100 loans originated) at an average loss severity of 10% after primary mortgage insurance. Yet historical experience drawn from studies done over many years suggests that a lifetime loss incidence on such a portfolio will be 1% to 2% under normal economic scenarios.

Finally, one clear measure of the magnitude of the lender's stake in the credit risk is the lender's ability to impact the credit rating of the pool. For a pool with the expected risk profile and product mix, the 60 basis point lender risk account is of sufficient size to potentially move the pool's rating up one or more grades, for example, from BBB to A, or A+ to AA.

After year 10, or sooner in the unlikely event that the lender risk account is exhausted, supplemental mortgage insurance will extend total loss coverage up to 60% of the original value on such loan. The company proposed for such coverage is AA+ rated by Standard and Poor's. The supplemental coverage, in addition to its value in achieving a AA rating on the portfolio, will provide catastrophic loss protection to the FHLBank, which is an exposure that is more appropriately and efficiently provided by the insurance industry than by any individual lender. Most lenders are unwilling or unable to assume this catastrophic level of risk due to their capital requirements for such exposure. The ability of the FHLBank to replace the supplemental mortgage insurance carrier if its credit rating drops below AA further protects the FHLBank against potential exposure due to deterioration of the financial strength of the mortgage insurance carrier.

Only after losses exceed the catastrophic level would the FHLBank's cleanup fund be tapped. Based on loss experience for normal pools, the FHLBank would be tapped only in highly unusual circumstances. After year 10, the lender risk account would be extinguished and the primary and supplemental mortgage insurance would pick up all first and second losses before the cleanup fund is tapped. However, loss experience after year 10 is minimal.

The treatment of credit risk in MPP has some important differences from the existing MPF. The chart below shows this. Under MPF, the FHLBank takes the first losses after primary mortgage insurance, of up to 0.225%; then the member takes the next 2.5% of credit losses. Under MPP, the member takes the first losses, up to 0.6%, and supplemental insurance takes the next 2.5%. This has two primary effects. First, an FHLBank has less total credit risk exposure under MPP than under MPF. Second, the member will normally take a larger share of the actual credit losses under MPP because it bears the first losses after primary PMI. Since the expected losses based on historical performance are 15 to 20 basis points after PMI, the member's loss account will absorb all the losses in nearly all possible scenarios. Under MPF, those losses will be absorbed by the FHLBank.



Notes:

For MPF - Initial FHLB exposure is 4.5 x 5.0 bp. Member exposure is estimated credit support.

For MPP - Member exposure is the total value of lender risk account. Insurer exposure is estimated minimum protection; maximum exposure is estimated to be 11.75%.

Alternative credit enhancements: In the MPP program, the majority of the credit risk is not shared solely between the FHLBank and its members. Rather, the program uses a third party mortgage insurer as part of the total AA credit enhancement. Alternative structures for handling risk were considered. For example, the member could initially assume the entire credit enhancement requirement and, in turn, lay a portion of the risk off with a third party. Recourse to the lender in case of failure of the supplemental mortgage insurance carrier was also considered. Unfortunately, if ultimate loss liability remains with the lender, full recourse capital treatment is triggered. A higher lender risk account was considered but rejected as it would bring the FHLBank's yield down to unacceptable levels.

The alternative credit enhancements were dismissed in favor of the described structure because it best meets the needs of our members while complying with the criteria outlined by the Finance Board for this program. Specifically, the lender risk account establishes and maintains a strong financial interest by the member in the long-term performance of the loans delivered to the Federal Home Loan Bank. The 60 basis points are substantial, affording coverage of all expected losses, even under adverse scenarios. Because this account is maintained by the Bank, it also provides assurance that this portion of the risk is retained by the member while affording the member reasonable loss exposure and related capital requirements.

Demand for product

The desire of FHLBank members for some sort of secondary mortgage program was first quantified in a survey taken as part of the System 2000 planning effort in 1992. Members have become increasingly interested in such a product since that time. Following the advent of MPF, members have stated that while that program offers some advantages, they would prefer a direct purchase program. These findings are summarized in Exhibit B.

The reasoning for a program such as MPP has remained stable over time. Members have expressed desire for

- an outlet for non-conforming loans (other than jumbos),
- working with their own Federal Home Loan Bank rather than an outside agency they do not own or have a relationship with,
- improved pricing,
- quality and flexibility in service,
- a clear risk-based capital treatment, and
- the ability to use existing operational methods.

The small- and medium-sized originators appear to find the most benefit in a direct purchase program. Smaller originators in particular cannot easily compete because large originators negotiate the best prices or reduced fees from secondary market agencies. Also, smaller originators are often concerned with satisfying the needs of individual mortgage customers whose prospective homes fail to meet conforming standards on some point, yet who are sound credit risks.

Product of unique and original value

One of the criteria for approval of a Federal Home Loan Bank mortgage program is that it must differ from existing secondary market programs. As we have described, MPP differs in several major areas, including risk sharing and the financial benefit available to lenders. Other factors that add value to this program are the cooperative nature of the System and flexibility in design elements.

Cooperative partnership: Through the lender risk account, the lender will assume the major portion of the credit risk and will thereby gain a significant financial benefit compared to what is gained from Fannie and Freddie. This ongoing financial interest after loan delivery serves to create a strong partnership between the lender as originator and the FHLBank as investor. This common interest in the long-term performance of each mortgage is absent in typical secondary market sales, and should act as a strong incentive to select and preserve excellent credit quality.

Depending on common interests is familiar to the players because of the cooperative nature of the FHLBank System. The retail lenders and the FHLBank purchasers currently work together in wholesale funding, sharing costs and profits. Under MPP, as with advances, the lenders will be responsible for the credit risk up to a level sufficient to cover nearly all losses, while the FHLBanks will be responsible for the interest rate risk. FHLBanks and their members will rely on working together to provide the best possible services in large and small markets, urban and rural areas, just as we do with advance and AHP services already.

As publicly traded companies, the secondary market agencies serve their owners best by concentrating on the most profitable sellers, the larger banks and mortgage companies. This trend is intensifying daily as more large mortgage originators sign "exclusive" deals with Fannie Mae or Freddie Mac. But FHLBanks are owned by members, and our Boards of Directors are structured to assure that all customer/shareholders are treated fairly. This, coupled with our own relatively small size, our excess capital for supporting mortgages on the balance sheet, and our lower required rate of return on capital, will enable us to support institutions of all sizes in funding their mortgage loans through mortgage sales.

Flexible structure: Fannie and Freddie have each developed proprietary risk evaluation and underwriting models and require seller-servicers to use these systems for a fee to receive streamlined documentation and/or pricing benefits. Lenders oppose this closed system practice because at the point of origination, the secondary market sale of the loan is not determined, which means that lenders may need to process loans through two systems at additional expense. This system of requirements is currently in flux, and the secondary agencies are beginning to be more flexible, at least for the very large sellers that sign exclusive deals with them. The FHLBanks will give all members operational flexibility and lower cost by purchasing loans processed through any of various systems that will be approved for MPP, including Loan Prospector, Desktop Underwriter, and selected private systems.

Another kind of flexibility lies in the regional nature of each FHLBank, which allows a greater opportunity to develop mortgage programs and related underwriting criteria to meet the specific needs of regional markets. For example, a common issue in rural communities is a high land value relative to improvements which exceeds agency standards. Loan-to-value restrictions on manufactured housing are another frequent issue. Both are difficult to accommodate under a national program but could be permitted locally by the FHLBank serving that district in line with local housing norms. Certainly Fannie and Freddie do at times accommodate certain customers through negotiating underwriting exceptions. However, such "deviations" could be incorporated into standard guidelines by a regional FHLBank. As each FHLBank is able to develop reasonable standards, it will be able to serve some of the housing needs that are currently not being completely met by the national GSEs, including affordable housing needs and non-conforming housing needs below the dollar ceiling.

Accounting treatment of MPP

The accounting pronouncement that covers this area is FASB 125 – Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This rule governs the accounting treatment for the sale of financial assets. The accounting will be identical to the sale of qualified loans and retention of servicing rights to other counter parties such as Freddie and Fannie. This means that the seller has to record the servicing rights based on market value. The one additional attribute of the MPP program is the 60 basis point holdback by the Federal Home Loan Bank. The rule recognizes that the transferor (the mortgage lender) may transfer less than an entire financial asset.

From lender's standpoint

Accounting: The lender receives cash for loans and estimates the fair value of the lender risk account/holdback as a receivable asset. The estimated value is the discounted cash flow of the expected payment amounts from the Federal Home Loan Bank. If the lender cannot estimate the fair value of the lender risk account, the lender will record this asset as $0 and recognize any payments as income when they are received from the Federal

Home Loan Bank. The lender will also book a premium and the servicing rights at their market value and will amortize them over the life of the loan. FAS 91 governs the treatment of the premium.

Risk-based capital treatment: If the lender is able to estimate the fair market value of the lender risk account and book it as an asset, the contractual right to receive payments from the risk account can be treated as a residual asset on the books of the transferor. The banking agencies' risk-based capital standards provide that the amount of risk-based capital that must be maintained for assets transferred with recourse should not exceed the maximum amount of recourse for which a bank is contractually liable under the recourse agreement. The rule, known as the low-level recourse rule, is explained in section RC-C Regulatory Capital of the call report instructions for commercial banks. Since the lender's maximum exposure under the lender risk account is 60 basis points, this is the maximum risk-based capital to report on RC-R item 3.e.

If the lender is unable to estimate the fair market value of the lender risk account and does not book the asset, then any future payments are taken as income when they occur and no risk-based capital is required.

From the Federal Home Loan Bank standpoint

The Federal Home Loan Bank pays the lender cash for the loan plus a premium and books the lender risk account/holdback as a 60 basis point liability. If there are no losses, then as the funds are due to the lender according to the schedule, the bank debits the liability and credits cash to be paid to the lender. If there are losses, the bank debits the liability and credits losses due to the default.

Comparative financial profiles

Exhibit C compares the financial impact of MPP with agency sales and MPF, combining the figures postulated below. First, we assume that in each case the member has originated a mortgage with a coupon of 7.50%. It is also assumed that the member retains 0.25% of the coupon as compensation for servicing, and that the investment yield for agency MBS is 6.75%.

Agency sale: The mortgage rate, net of servicing is 7.25% (7.50 – 0.25). If the member pays Fannie or Freddie a guarantee fee of [redacted]%, the member is able to retain [redacted]% in excess servicing, or profit on the loan.

Note rate	7.50%
Servicing	(0.25)

Guarantee fee	([redacted])
Excess servicing	([redacted])
Investment coupon	6.75%

Mortgage Partnership Finance®: Again, the mortgage rate, net of servicing, is 7.25%. The FHLBank establishes a first loss account by retaining [redacted] basis points. The member is paid [redacted] basis points for bearing the potential loss on all loans sold, up to approximately [redacted] of the loan balances. Setting the excess servicing at [redacted] basis points (equal to the agency sale), [redacted] basis points remain that are available to subsidize the price paid to the member.

Note rate	7.50%
Servicing	(0.25)
First loss account	([redacted])
Credit enhancement fee	([redacted])
Available for subsidy	([redacted])
Excess servicing	([redacted])
Investment coupon	6.75%

In this instance, the member receives [redacted] basis points in credit enhancement fee relative to an agency sale. If the full amount available for member subsidy ([redacted] basis points) is also paid to the member, it receives [redacted] basis points more than if it had sold the loan to Fannie or Freddie. If losses exceed the amount available in the first loss account, the benefit will be reduced and may result in a net loss.

Mortgage Partnership Program: The mortgage rate net of servicing is 7.25%. The FHLBank will pay [redacted] basis points to the member over a ten-year period. These payments will be reduced by any losses on the associated mortgages, thus creating a positive incentive to deliver high-quality loans. The value of this payment on an interest yield basis is [redacted] basis points.[1]

The supplemental insurance, which is the key to achieving preferential capital treatment, will cost [redacted] basis points, and the cleanup fund is expected to cost 1 basis point. Both are paid by the FHLBank. Assuming the member

[1] Present value of [redacted] basis points, discounted at [redacted]% over the ten-year schedule is [redacted] basis points. This is equivalent to an [redacted] basis point annual interest flow.

receives [redacted] basis points in excess servicing, this results in an amount available for a member subsidy of [redacted] basis point.

Note rate	7.50%
Servicing	(0.25)
Lender risk account	([redacted])
Supplemental insurance	([redacted])
Cleanup fund	([redacted])
Available for member subsidy	([redacted])
Excess servicing	([redacted])
Investment coupon	6.75%

In this case, the member receives the value of the lender risk account (net of losses). If the amount available for member subsidy is also paid out ([redacted] basis point), the member will potentially receive up to [redacted] basis points more than is available from an agency sale.

MPP compared to agency sale: Under MPP, the member will receive agency price plus the amount available for member subsidy [redacted] basis point). On a present value basis, this [redacted] basis point provides about [redacted] basis points in price benefit to the seller. This payment is not contingent on the performance of the loans, so at the time of sale, the member will know the minimum amount it will receive for its loans. However, the member will also receive [redacted] of the loan amount (or [redacted] basis points annual flow), which will be reduced by actual loan losses.

MPP compared to MPF: Assuming that the amount available for member subsidy is paid to the member, MPF will provide the member with the agency price plus [redacted] basis points of credit enhancement fee and [redacted] basis points in member subsidy. The potential payment to the member beyond the agency price is [redacted] basis points versus a potential [redacted] basis points for MPP. The difference, however, is more than offset by two primary factors.

First, the capital treatment for MPP, as discussed previously, is significantly better than for MPF. Since credit losses are applied to future payments from the lender risk account, instead of borne directly by the member, negative or ambiguous capital requirements are avoided. Second, since MPP does not require the loans to be closed in the name of the FHLBank, the members' workflow process is not disrupted. The separate work process needed for MPF itself adds a few basis points of cost to each loan. Also, mortgage production from our members' wholesale networks can be better accommodated under MPP.

Conclusion

This paper presents the major reasons behind the creation of the Mortgage Partnership Program, and outlines its major features. The FHLBanks of Cincinnati, Indianapolis, and Seattle now request the approval of the Finance Board to move forward in developing the details of the program. We sincerely believe that the cooperative ownership of the System offers a unique opportunity for us to work in partnership with our over 1433 members to improve the retail consumer's access to economical home financing.

Exhibit A

Verner, Liipfert opinion on legality of approval

VERNER·LIIPFERT
BERNHARD·McPHERSON & HAND
CHARTERED

901 - 15TH STREET, N.W.
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March 1, 1999

Mr. Jonathan R. West
Federal Home Loan Bank of Indianapolis
8250 Woodfield Crossing Boulevard
Indianapolis, Indiana 46240

Re: Mortgage Purchase Program

Dear Mr. West:

DOCUMENT REDACTED – 10 PAGES

Exhibit B

Market Demand for the Mortgage Partnership Program

The evidence cited below is in addition to numerous discussions with individual members and Boards of Directors by marketing and calling officers at each Bank. Member interest has been in favor of a direct purchase program steadily in recent years.

1996:

- Both Seattle and Indianapolis surveyed members; found interest in mortgage purchase around 70%.
- Indianapolis interviewed 25 members re early version MPP. Responses:
  - Small communities want us to purchase non-conforming loans.
  - Most prefer to work with FHLBank, not outside groups, because of trust in FHLBank and its quality service.
  - Cost of certification as agency seller high; some sell to independents at lower price to avoid certification.

1998:

- Seattle officers and consultant surveyed 30 customers in depth re MPP / MPF. Responses: members want these.
  - Best price / execution.
  - Service–flexibility in underwriting, turnaround, automation.
  - Reliability / stability over time.

  All but four want some mortgage purchase.
  Two-thirds prefer direct purchase over MPF.

- Cincinnati surveyed all members; the two-thirds responding favor some mortgage purchase program at the FHLB.

- Indianapolis and its largest borrower met with Chicago; Chicago called on two other large members; none want Indianapolis to make MPF available; all prefer MPP.

1999:

- Cincinnati held focus group with selected members to review MPF and alternatives; none like MPF due to capital requirements; most prefer MPP.

- Seattle presented MPP with [redacted] approach to 22 thrift CEOs; audience in favor.

- Seattle discussed MPP with [redacted] approach with six members individually. Responses:
  - MPP superior to agency because of premium up front and risk account.
  - MPP superior to MPF because of reasonable treatment of risk-based capital, operational mechanics similar to agency process, service all through local FHLBank.

Exhibit C

Comparison of pricing among three purchase methods

	Agency	MPF	MPP
Note rate	7.50	7.50	7.50
Servicing	(0.25)	(0.25)	(0.25)
Guarantee fee	[redacted]		
First loss account		[redacted]	
Credit enhancement fee		[redacted]	
Lender risk account			[redacted]
Supplemental insurance			[redacted]
Clean up fund			[redacted]
Available for member subsidy		[redacted]	[redacted]
Excess servicing	[redacted]	[redacted]	[redacted]
Investment coupon	6.75	6.75	6.75